

Message Text

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ACTION EA-12

INFO OCT-01 ISO-00 AGRE-00 CEA-01 CIAE-00 COME-00
DODE-00 EB-08 FRB-03 H-01 INR-10 INT-05 L-03
LAB-04 NSAE-00 NSC-05 PA-01 CTME-00 AID-05 SS-15
STR-07 ITC-01 TRSE-00 USIA-06 SP-02 SOE-02 OMB-01
DOE-11 XMB-02 STRE-00 /106 W

-----022303 171012Z /20

R 170832Z MAR 78

FM AMEMBASSY SEOUL

TO SECSTATE WASHDC 9914

INFO AMEMBASSY TOKYO

LIMITED OFFICIAL USE SECTION 1 OF 2 SEOUL 2181

E.O. 11652: N/A

TAGS: EFIN, KS, US

SUBJECT: DECLINING U.S. DOLLAR PROMPTS ROKG MEASURES

REF: SEOUL 1258 (NOTAL)

BEGIN LIMITED OFFICIAL USE. SUMMARY: KOREAN PRESS IS BEGINNING TO FOCUS INCREASINGLY ON PROBLEM OF DECLINING U.S. DOLLAR AND ADVERSE IMPLICATIONS FOR KOREA. PRESS COMMENTARY EXPRESSES CONCERN THAT KOREA'S FOREIGN EXCHANGE RESERVES, ROUGHLY 90 PERCENT OF WHICH ARE HELD IN DOLLARS, ARE STEADILY DECLINING IN VALUE VIS-A-VIS STRONG CURRENCIES. FURTHERMORE, FACT THAT VALUE OF KOREAN WON IS TIED TO DOLLAR MEANS THAT EXPORTS TO STRONG-CURRENCY COUNTRIES ARE EARNING LESS FOREIGN EXCHANGE WHILE IMPORTS ARE BECOMING INCREASINGLY EXPENSIVE -- A PARTICULARLY WORRISOME PROBLEM IN TRADE WITH JAPAN, WITH WHOM KOREA ALREADY CARRIES HEAVY BALANCE OF TRADE DEFICIT. IN ADDITION TO MEASURES AIMED AT REDUCING DEFICIT WITH JAPAN, KOREANS HAVE BEEN QUIETLY PURSUING A POLICY OF DIVERSIFYING FX RESERVES AWAY FROM DOLLAR INTO STRONGER CURRENCIES SUCH AS YEN, AND DEUTSCHEMARK. SHIFT
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AWAY FROM DOLLAR HAS APPARENTLY BEEN ON ORDER OF A FEW HUNDRED MILLION DOLLARS. THERE IS NO INDICATION AT THIS TIME, HOWEVER, THAT ROKG IS GIVING SERIOUS CONSIDERATION TO ADOPTING A FREE FLOATING EXCHANGE RATE FOR KOREAN WON.
END SUMMARY. END LIMITED OFFICIAL USE.

1. BEGIN UNCLASSIFIED. AFTER REMAINING RELATIVELY SILENT

ON THIS SUBJECT, KOREAN PRESS IN PAST FEW DAYS HAS BEGUN TO FOCUS ON PROBLEM OF STEADILY DECLINING VALUE OF U.S. DOLLAR VIS-A-VIS CERTAIN STRONG CURRENCIES, AND THE DIFFICULTIES THEREBY POSED FOR KOREA. ARTICLES CONVEY A SENSE OF ALARM AND CALL UPON ROKG TO TAKE APPROPRIATE CORRECTIVE ACTION.

2. ESSENTIALLY, PROBLEM FOR KOREA IS SEEN AS TWOFOLD: FIRST, FACT THAT ROUGHLY 90 PERCENT OF KOREA'S FOREIGN EXCHANGE RESERVES ARE HELD IN DOLLARS MEANS THAT RELATIVE VALUE OF KOREA'S RESERVE IS DECLINING WITH EACH PASSING DAY; SECOND, SINCE VALUE OF KOREAN CURRENCY IS TIED TO THAT OF DOLLAR -- AND THEREFORE DECLINING, ALONG WITH THE DOLLAR, VIS-A-VIS STRONG CURRENCIES -- KOREAN EXPORTS TO STRONG-CURRENCY COUNTRIES ARE EARNING LESS FOREIGN EXCHANGE, WHILE KOREAN IMPORTS FROM JAPAN AND EC COUNTRIES ARE BECOMING STEADILY MORE EXPENSIVE. IN THE SHORT RUN, AT LEAST (I.E., UNTIL RELATIVE CHEAPNESS OF KOREAN EXPORTS LEADS TO GREATER EXPORT VOLUME), KOREANS FEAR THEIR TRADE POSITION COULD BE SERIOUSLY AFFECTED.

3. PROBLEM IS SEEN AS PARTICULARLY SEVERE WITH REGARD TO KOREA'S TRADE WITH JAPAN. EVEN WITHOUT FURTHER DOLLAR DECLINE, GROWING TRADE DEFICIT WITH JAPAN (\$1.8 BILLION IN 1977) IS SEEN AS CAUSE FOR SERIOUS ALARM. SHORT-TERM EFFECT OF CONTINUED DOLLAR (AND WON) DECLINE WILL BE TO LIMITED OFFICIAL USE

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FURTHER DEEPEN THAT DEFICIT. MOREOVER, PROSPECTS FOR LONGER-TERM COMPENSATING TRADE MOVEMENTS DO NOT OFFER MUCH HOPE SINCE KOREA'S DEMAND FOR (LARGELY ESSENTIAL) IMPORTS FROM JAPAN IS RATHER INELASTIC, WHILE POSSIBILITIES FOR INCREASED EXPORTS TO JAPAN'S PROTECTED MARKET ARE LIMITED.

4. ACCORDING TO ONE NEWS REPORT, GOVERNMENT "HAS DECIDED" THAT A NUMBER OF CORRECTIVE MEASURES "ARE NECESSARY." THEY INCLUDE: (A) DIVERSIFICATION OF RESERVE HOLDINGS AWAY FROM HEAVY DEPENDENCE ON DOLLAR AND INTO STRONGER CURRENCIES; (B) DIVERSIFICATION OF IMPORT SOURCES AWAY FROM JAPAN, IN FAVOR OF WESTERN SUPPLIERS (SEE REFTTEL); AND (C) CONTINUATION OF RECENT POLICY INNOVATION WHEREBY FX LOANS FOR IMPORTED CAPITAL EQUIPMENT FROM JAPAN ARE DENOMINATED IN YEN (RATHER THAN DOLLARS, AS IN THE PAST) SO THAT IMPORTERS ARE FORCED TO BEAR EXCHANGE RISK. END UNCLASSIFIED.

5. BEGIN LIMITED OFFICIAL USE. COMMENT: THIS IS NOT OUR FIRST INDICATION OF AN ROKG POLICY TO DIVERSIFY FX RESERVES AWAY FROM THE DOLLAR. WE HAVE DISCERNED MOVEMENT IN THAT DIRECTION FOR PAST SEVERAL MONTHS. IN ADDITION, MINFIN BRIEFING PAPER FOR PRESIDENTIAL INSPECTION VISIT IN

JANUARY NOTED THAT ROKG WOULD STRIVE TO INCREASE THE PROFITABILITY OF ITS FX RESERVE PORTFOLIO BY HOLDING STRONG CURRENCIES. ASKED TO COMMENT ON NEWS REPORT QUOTED PARA (4) HOWEVER, MINFIN AND BANK OF KOREA OFFICIALS DENY THAT DIVESTITURE OF DOLLARS IS A WELL-DEFINED, STRONGLY-PRUSUED POLICY. ROKG HAS NO GOAL IN MIND, FOR EXAMPLE, RE PERCENTAGE CEILING OF RESERVES TO BE HELD IN DOLLARS. RATHER, MOVEMENT AWAY FROM DOLLARS HAS BEEN GRADUAL PROCESS, BEGINNING SECOND QUARTER OF 1977, IN RESPONSE TO GRADUAL DECLINE OF HEAVY DEPENDENCE ON U.S., GROWING TRADE TIES WITH EUROPE, AND PRINCIPLES OF SOUND PORTFOLIO MANAGEMENT. PROCESS, ACCORDING TO OUR SOURCES, IS LIKELY TO CONTINUE IN SAME GRADUAL WAY FOR FORESEEABLE FUTURE.

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6. BREAKDOWN OF KOREA'S FOREIGN EXCHANGE RESERVES, BY CURRENCY, IS NOT NORMALLY MADE AVAILABLE. WE HAVE, HOWEVER, BEEN ABLE TO OBTAIN FOLLOWING PARTIAL STATISTICS WHICH REFLECT TREND DESCRIBED ABOVE:

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ACTION EA-12

INFO OCT-01 ISO-00 AGRE-00 CEA-01 CIAE-00 COME-00
DODE-00 EB-08 FRB-03 H-01 INR-10 INT-05 L-03
LAB-04 NSAE-00 NSC-05 PA-01 CTME-00 AID-05 SS-15
STR-07 ITC-01 TRSE-00 USIA-06 SP-02 SOE-02 OMB-01
DOE-11 XMB-02 STRE-00 /106 W
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FM AMEMBASSY SEOUL
TO SECSTATE WASHDC 9915
INFO AMEMBASSY TOKYO

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KOREAN FX RESERVES (\$ MILLIONS)

	OCT. 31, 1977		DEC. 31, 1977	
	VALUE	P.C.	VALUE	P.C.
U.S. DOLLAR	3,932.8	92.4	3,795.3	88.1
JAPANESE YEN	144.4	3.4	220.9	5.1
DEUTSCHEMARK	120.9	2.8	208.6	4.8
BRITISH POUND	6.9	0.2	48.3	1.1
FRENCH FRANC	2.9	0.1	1.2	0.03
OTHERS	21.3	0.5	14.0	0.3
SUB-TOTAL	4,229.2	99.4	4,288.3	99.6
GOLD, SDR'S AND OTHER				
RESERVES	26.6	0.6	18.1	0.4
(GOLD)		(6.2)		
(SDR)		(11.9)		
TOTAL	4,255.8	100.0	4,306.4	100.0

7. ONE KOREAN PRESS COMMENTARY HAS URGED GOVERNMENT TO UNTIE KOREAN WON FROM DOLLAR AND ADOPT FREE FLOATING EXCHANGE RATE. WE HAVE NO INDICATION, HOWEVER, THAT SERIOUS CONSIDERATION IS NOW BEING GIVEN THIS COURSE LIMITED OFFICIAL USE

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OF ACTION. IN FACT, ACCORDING TO ONE SOURCE, THERE ARE THOSE IN ROKG WHO ARE GLAD TO SEE KOREAN WON DECLINE ALONG WITH DOLLAR, BECAUSE OF THE EFFECT IN MAKING KOREAN EXPORTS MORE ATTRACTIVE IN TERMS OF PRICE. IN THE PAST, KOREANS HAVE HAD TO DEVALUE UNILATERALLY IN ORDER TO ACHIEVE THIS RESULT. "RIDING DOWN WITH THE DOLLAR REMOVES THE NEED TO TAKE SUCH ACTION, AND FOR THAT REASON, UNTYING OF THE WON FROM THE DOLLAR DOES NOT APPEARS TO BE IN THE CARDS FOR FORESEEABLE FUTURE.

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Message Attributes

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Draft Date: 17 mar 1978
Decaption Date: 01 jan 1960
Decaption Note:
Disposition Action: RELEASED
Disposition Approved on Date:
Disposition Case Number: n/a
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